How can wealth be taxed? Debates in Britain since the First World War

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A wealth tax is now frequently discussed. The Wealth Tax Commission report – two of whose authors are present – pointed out that 'Public attitudes show a clear desire for wealth to be taxed more, relative to labour. Work on public attitudes carried out as part of the research of this Commission showed a clear preference for any tax increases to fall on wealth rather than on income. A wealth tax – rather than some other tax on wealth – was the most popular suggestion'. The Commission considered both an annual wealth tax as a permanent feature and a one-off wealth tax as an exceptional response to a particular crisis. It favoured a one-off wealth tax: 5 per cent paid at 1 per cent pa over 5 years on assets over £500,00 would produce £262bn or on assets over £2m would produce £80bn. Such a one-off tax, so the Commission argued, would not distort behaviour, unlike income or capital taxes – provided it was credibly one-off. It would be difficult to avoid since it would be based on behaviour that had already occurred; it would be based on open market value, with payment deferred for those with liquidity constraints. An annual wealth tax had more problems: it would require annual reassessments, and would affect future behaviour, and lead assets to move.

In January 2023, a YouGov survey found that 78 per cent of respondents supported and only 9 per cent opposed a wealth tax of 1 per cent on wealth above £10m; 73 per cent supported and 12 per cent opposed a tax of 2 per cent on wealth above £5m. However, support fell to 53 per cent for a tax of 1 per cent a year for 5 years on wealth above £500,000.[1]

[1] https://docs.cdn.yougov.com/f5nwpnhjzf/Internal_LabPolicies_230119.pdf

Despite these calls for a wealth tax, they are in retreat. In 1990, 12 OECD countries had a wealth tax; by 2018, only four remained – France, Norway, Spain and Switzerland. In Norway, the tax is 1 per cent above a threshold of about £130,000 rising to 1.1 per cent above about £1.5m; the tax accounts for 1 per cent of tax revenue. Recent reports on Norway suggest that a slight increase in the wealth tax led top wealth owners to leave, with a consequent loss of tax revenue. A recent article in *Taxation* warns 'A wealth tax is a temporary solution with a lasting negative effect on the economy, which Norway, to its detriment, is beginning to realise. UK beware!'[2] These taxes are annual. Arguably, a one-off tax would not lead to the same problem if it is credible that he tax will not repeated and that it is for a specific purpose.

Although the OECD report accepted the need for action on inequality of wealth, it was sceptical that wealth taxes provided the solution. They were seen as more destructive and less equitable that 'broad-based personal capital income taxes and well-designed inheritance and gift taxes'.[3] This talk will largely take the OECD line.

What I will argue is:

- A wealth tax, whether one-off or annual, has failings that are apparent in the discussions in Britain since the First World War. Despite considerable pressure to introduce such taxes at particular moments, they have never been implemented.
- There is a need to tax wealth which is not necessarily a disincentive to risk-taking and economy growth; on the contrary, wealth can arise from rent-seeking behaviour and from passive inheritance. There is a need to rebalance taxation of earned income and capital that can lead a more dynamic economy.
- The way to achieve this outcome is through a range of taxes, especially at points at which wealth is valued or realised.

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[2] Des Hanna, 'Plucking the goose', *Taxation* 18 May 2023.,

[3] OECD, *The Role and Design of Net Wealth Taxes in the OECD*, Paris, 2018.

The conscription of wealth: Labour and the capital levy

This proposal during and after the First World War was, like the Wealth Tax Commission, a one-off capital levy to deal with a specific problem – the cost of the war and post-war debt. Labour had been conscripted to fight the war, with a loss of life and limb, and an uncertain economic future. Why should wealth which had been protected by soldiers' sacrifice or benefitted from profiteering, not make a contribution?

The case was made, among others, by the TUC in September 1916:

> that, as the manhood of the nation has been conscripted to resist foreign aggression, the maintenance of freedom, and the protection of capital, this Congress demands that such a proportion of the accumulated wealth of the country shall be immediately conscripted as is necessary to defray the financial liability incurred by the prosecution of the war, and thus avoid borrowing huge loans upon which enormous sums will have to be paid in interest by future generations, which will handicap the industries of the country in national and international competition, diminish trade and impoverish the people.

The suggestion was not feasible during the war given the difficulties of compiling a census of wealth, and it would not produce money quickly enough. After the war, the idea was supported by some leading economists who followed David Ricardo after the Napoleonic wars, such as AC Pigou with some backing from the Treasury and Conservative politicians in order to reduce the debt. It would fall on past accumulations of wealth rather than future savings and investment so would not be a disincentive; and it would be an insurance policy, preventing attacks on rentier capital from become wider. But it was above all associated with the Labour Party – Sidney Webb, Hugh Dalton - as part of its campaign in the general elections of 1918 and 1922. It allowed Labour to claim that it represented active labour – workers by hand and brain, including industrialists: it would allow a cut in income tax that fell on active employment at the expense of passive wealth. It would – so it was hoped – construct a producers' alliance against rentiers 'who can live in idleness on the productive work of others'.

A less radical solution was a tax on war wealth to satisfy critics of profiteering and to contained Labour's demands for a general levy on capital. Austen Chamberlain, the Chancellor of the Exchequer, saw that 'The prejudice against great wealth in pockets is a danger to all capital. The wealth has come to men too rapidly and they have waxed fat while the mass has grown poorer'. But he was wary, given 'the unreasoning fear of the City'. Winston Churchill was more confident: he could 'not see how the defence of the Government is to be conducted on a democratic platform if we turn down the scheme of taxing war fortunes…. Look at the position of Capital if you fail to carry with you the working classes… It will be said that we are in the grip of the plutocracy and it will be said with a certain truth'.

The coalition Cabinet rejected the proposal from fear of alienating industrialists without convincing Labour that it had solved the problem. It would create a precedent that 'lets in the wolves for a bite'.

Labour continued to press for the capital lev – but there were problems.

- Was it credibly one-off or might it be repeated?
- Opponents argued that lags, market imperfections, and differences in preferences between those selling assets to raise cash and those purchasing.
- The solution could be for the state to hold the shares which led to worries that the levy was surreptitious nationalisation and socialisation, as advocated by Webb as a member of the Sankey commission and in he Labour party constitution. One Conservative commentator saw 'Socialism by a tricky device'.
- Or would it pay for improved welfare rather than pay off the debt? Labour politicians were not consistent over the purpose.
- Was there really a clear distinction between parasitical rentier wealth and productive earned income? Why should retired businessmen or widows whose pensions depended on savings be taxed and not civil servants with state pensions? Webb saw the problem: wealthy individual 'cowers behind the bulwark of the poor widow, the "lean annuitant", and the people who have laboriously accumulated a few hundreds in Government stock by way of provision for their old

age'. Opponents could claim that the levy was an attack on property. Rather than a producers' alliance in support of the levy, a property alliance was ranged against the levy.

- Inland Revenue and Treasury feared intrusive assessments that would undermine the cooperation of taxpayers and the legitimacy of the fiscal system
- Would it produce the revenue that was claimed? The Labour party manifesto of 1922 put the net yield at £150m but soon realised it would be much less. JC Stamp put the yield at £42m to £50m. Surrender of assets in the present would reduce revenue from income tax and death duties in the future.

Although support for the capital levy was reaffirmed in the party conference of 1923, the leadership distanced itself from 'an electoral millstone' and barrier to being seen as fit to govern in 1924.

Despite the rejection of the capital levy, there were other ways of taxing capital. Churchill had been a supporter of taxation of land and other unearned income as a Liberal before the First World War – and his support for free trade was linked with a desire to prevent monopoly profits and rents. At this point, he stressed that property needed to be associated with beneficial processes if it were not to be molested: 'when it is associated with ideas of wrong and of unfairness, with processes of restriction and monopoly, then … property will be assailed and ill be endangered'. Although land taxation was abandoned as a price for Conservative support for the coalition, Churchill still followed his earlier liberal values in defence of capital taxation, both in 1920 and as Chancellor of the Exchequer from 1924 to 1929. He complained about the cost of debt service which created 'an immense class quartered in perpetuity upon the struggling producers of new wealth'. He suggested a forced loan to pay off the debt – and he increased death duties in order to reduce income tax. As he said in 1925, the aim of his budget was to escape from debts and achieve higher growth 'by the energetic creation of new wealth' rather than 'squatting on old wealth'. 'A premium on effort is my aim and a penalty on inertia may well be its companion'.[4] The graph from Piketty shows that the top marginal rate of inheritance rose

[4] Daunton, 'Churchill's economics'.

between the wars and accounted for up to 10 per cent of government revenue. Rent controls and falling land values also shifted the wealth distribution.

Second World War and post-war fiscal regime

During the Second World War, the idea of a capital levy returned, though with less enthusiasm. In 1940, in *How to Pay for the War,* Keynes made the case for a postwar capital levy of around 5 per cent which he explained in a letter in *The Times* would reward 'the risks, the labours, and the abstinences of wartime at the expense of the old wealth which they will have served to safeguard'.[5] Dalton, a supporter of a capital levy after the First World War, was now in the coalition government and served as Chancellor after the war. Nevertheless, the general sentiment was that a capital levy or one-off wealth tax was not needed: the two aims of funding the war and creating a more equal distribution of wealth could be achieved by other means.

Keynes had linked his postwar capital levy with 'deferred pay' as a way of removing excess consumption during the war in order to contain wartime inflation and to prevent postwar depression. Most unions were sceptical – would deferred pay really be paid; was it a device to reduce real wages?

Some Labour politicians did support a capital levy, but there were also serious doubts. After all, high levels of income tax in the war were a form of levy in forcing the rich to live off their capital; and the revenue from any levy was not sufficient to justify the electoral dangers of giving the Tories 'a great opportunity to terrify the electorate'.

In 1942 and 1943, Keynes, John Hicks and James Meade discussed the pros and cons of a capital levy but the most serious investigation was the National Debt Enquiry of 1944. The Economic Section and

[5] JMK Collected Works, 22, 121-2; J M Keynes, *How to Pay for the War*, London, 1940.

Treasury embarked on a study of the issue which concluded that a capital levy was not the answer for reduction of the postwar debt.

- Serious administrative problems
- It would dislocate capital markets
- War wealth was more widely distributed than in the First World War, with borrowing at a lower interest rate, and taxation providing more of the finance.
- Debt could be reduced by holding down interest rates and encouraging growth to reduce its real value – the opposite of 1919 when interest rates were raised.
- Net savings from the level would be less than after the First World War: low interest rates reduced the savings from debt redemption while progressive taxation increased the potential loss of revenue. Securing a reasonable revenue would mean a heavy levy on small property which would be politically dangerous and do little for incentives.

Keynes and Meade did see virtue in an annual capital tax rather than a 'catastrophic capital levy' to offset the disincentive of high income tax. Douglas Jay and Roy Jenkins supported a capital tax as a means to deal with inequality of wealth, and also to offer incentives: the tax fell on capital values and not the flow of income, so that a capital tax would encourage a shift from safe to more risky investments in order to secure a higher yield.

Neither a capital levy nor an annual wealth tax was adopted after the war.

Redistribution could be achieved by higher death duties which were raised by Dalton on estates over £21,500 to 75 per cent and further by Gaitskell to 80 per cent. Dalton also argued that low interest rates reduced the income of rentiers. Nationalisation and differential taxation of profits to encourage retentions would reduce wealth inequality and stimulate growth. It was a different approach from Keynes and Meade who favoured risk and enterprise – to them, an annual wealth tax was part of a free enterprise economy rather than rigid planning.

There was some discussion of a capital gains tax to balance capital and labour. RH Tawney felt that 'the immunity from taxation which speculative plunder continues to enjoy has as much justification as a close season for sharks'. Jenkins was not convinced. After all, the US had a CGT without a socialistic distribution of property, and it would hit active producers rather than passive capital. 'If our object is to promote as much equality as is compatible with the maintenance of reasonable incentive, a capital gains tax is indeed the least desirable of all forms of attack upon property'. Jenkins returned to a capital levy, not to pay for the debt but to encourage equality and to deal with what Hicks called an 'empty economy' – a lack of goods, inflation contained by controls. A capital levy would prevent consumption out of capital and encourage unions to accept a wage freeze. The result was Stafford Cripps's 'special levy' of 1948 – a one off levy on investment income.

Charles Feinstein estimated that the share of wealth owned by the top 5 per cent fell from over 75 per cent before the war to under 40 per cent by 1976-80; and the share of top 10 per cent fell from 85 per cent before the war to 50% by 1976-80. Contemporaries did not have data on this trend, and to many Labour politicians, progress on income inequality had not been complemented by sufficient progress on wealth inequality which remained a serious block to opportunity.

The return of wealth tax

Proposals for a wealth tax emerged in the early 1960s. In 1955, Nicholas Kaldor argued that taxation should fall on all receipts – income, gifts, capital gains, bequests – with deduction of savings. His solution was a progressive expenditure tax, that is all receipts less savings. He argued it would be superior to a capital levy in reducing inequality. However, he accepted such a sweeping change was not likely – same result could be achieved by different ways. In 1964, he called for an annual wealth tax: 'not only income but wealth that represents spending power and … an equitable tax system should take account of both'.

In the early 1960s, Labour was concerned both with inequality and with equity – the need to tax capital as a major element of a person's economic capacity at a time when income was already heavily taxed. A difficulty was that the two motives of equality and equity led to two different forms of wealth tax:

- Equity: a low threshold and low rates alongside income tax, including middle-class home ownership. This would require a large administrative effort.
- Equality: a high threshold with progressive rates which would be easier to administer but politically risky.

The Labour manifesto for 1964 did not propose an annual wealth tax – instead it focussed on a capital gains tax, on the grounds that 'Taxation must be fair and must be seen to be fair. The present situation where the largest gains are made, not through hard work but through the untaxed rewards of passive ownership of Stock Exchange speculation, must be ended.'

The CGT was introduced in the 1965 budget. The idea had been prepared by the Conservatives who adopted a short-term CGT in 1962 to deal with criticism of property speculators. Callaghan, and his adviser Kaldor, saw it as a partial step towards aims of the expenditure tax for equity – and as a component of incomes policy, a complement to wage restraint.

Not everyone agreed that the CGT was the best approach. Like Jenkins, Harold Lever thought it merely encouraged retention of assets rather than their use for new purposes. He preferred a wealth tax which would encourage the more productive use of capital.[6] By 1969, the TUC was turning to a wealth tax: TUC tuned to wealth tax in 1969: 'The ownership of large concentrations of wealth conveys very great power, both economic and political, which the recipient may have done nothing more to earn than being born in the right bed'.[7] The TUC called for a progressive wealth tax above £20,000 that would fall on inheritances rather than savings. Jenkins, now Chancellor of the

[6] Whiting 165.
[7] Whiting, 194.

Exchequer, was doubtful: there were problems of valuing assets which did not have a market price; and there would be too much pressure on Inland Revenue which was already dealing with the reforms of 1965.

On the right, a wealth tax could be justified on grounds of efficiency - a way of stimulating enterprise. The tax would fall on the asset and not the yield which would encourage a shift from safety and low yields to seek higher returns that would encourage entrepreneurialism. The tax might break up passive accumulations of past wealth and allow a cut in higher rates of income tax. This argument had been used by Jay and Jenkins, and it had cross-party support. In 1963, the economist Alan Peacock noted that 'the net wealth tax gets high marks from economists'.[8] Such was the view of the NEDC's *Conditions Favourable to Economic Growth* of 1963.

The Conservatives embarked on a major reassessment of tax policy in opposition after 1964 with the aim of encouraging efficiency and enterprise, by improving personal incentives and broader ownership of capital. One member of the committee, William Rees-Mogg, thought that salaried and professional men could not accumulate capital because of high personal taxation – but those with large fortunes could avoid taxation with the result that 'the present system is weighted against the modest capitalist or would be capitalist compared to the man with a very large fortune'. What was needed was lower direct taxes to allow accumulatio of fortunes up to say £25,000. In order to encourage these accumulations and to discourage passive old fortunes, the committee turned to an annual tax on wealth which Angus Maude thought was 'really the keystone of the arch'. It rested on the logic of the NEDC that it would encourage a shift to higher yielding assets and would provide an incentive to create wealth – and could be sold as a quid pro quo for cutting high income tax. William Clark, a MP on the committee, saw the aim as 'to place more burden on the static existing accumulations of wealth and this to avoid the present concentration of the burden of tax on the creation of wealth'. Nigel Lawson

[8] Whiting, 190

agreed. The aim was to attack a 'property-owning gerontocracy' and create active entrepreneurial wealth.

The proposal also faced opposition:

- Would the impact of wealth tax be large? The CBI had doubts on the efficiency argument: wealth was mainly held by older people, so it was more likely to be used to maintain consumption or to pass assets to children than to seek riskier, high-yield investments. In 1968, they concluded that the case for the tax was 'its socialist qualities as a transfer of assets from the richer taxpayers to the state'.[9]
- Being advocated by Labour to redistribute wealth – Rees-Mogg turned to Pitt and taxation of the fruit and not the tree. It would be 'a direct invasion of the right to hold private property without disturbance'. It 'creates a powerful agency of socialism'.
- Difficult to explain to electorate the logic of both encouraging accumulation and taxing wealth. Iain MacLeod: 'the important things on which the Conservative Party ought to be concentrating attention were earning, owning, saving and learning. A proposal to introduce a wealth tax would distract from these objectives'.

The committee was split and in 1968 the idea was rejected by the shadow Cabinet.

As the Conservatives moved away from a wealth tax, Labour become more committed. It was a key element of the manifesto of February 1974:

> 'REDISTRIBUTE INCOME AND WEALTH. We shall introduce an annual Wealth Tax on the rich; bring in a new tax on major transfers of personal wealth; heavily tax speculation in property - including a new tax on property companies; and seek to eliminate tax dodging across the whole field.'

[9] Whiting 193

The manifesto for October 1974 continued the theme:

> 'Labour believes … that taxation must be used to achieve a major redistribution of both wealth and income…. The next Labour Government will introduce an annual tax on wealth above £100,000. We will also legislate for the introduction of the Capital Transfers Tax - which will, for the first time this century, make the Estate Duty an effective tax on inherited wealth.'

The main motivation for the wealth tax was to reduce inequality and deal with inherited wealth which was not being tackled by estate duty.

It might also appeal on grounds of equity by balancing taxes on income compared with capital, and self-made wealth compared with inherited wealth. In 1975, Nigel Lawson accepted there was a 'reasonably strong case' for a wealth tax. And if the tax threshold was high, not threaten small business: it would preserve capitalism and remove plutocracy. Labour did not develop this point: it stressed redistribution and did not give weight to popular capitalism.[10]

Opinion poll data complied by David Cawood shows that there was considerable support for a wealth tax in 1974:

	Support	oppose	don't know
March 1963	42	44	14
March 1974	67	30	3
May 1974	72	22	6
May 1979	49	51	19

[10] Whiting 220.

This was potentially the moment when a wealth tax might have been implemented – but it did not happen other than a capital transfer tax in 1974 that dealt with *inter vivos* gifts. The failure of the wealth tax provides an example of Jill Rutter's discussion of how tax policy was made.

The government issued a Green Paper in August 1974. What would the next step be? The government could proceed to a White Paper, but the Inland Revenue and then, more forcefully, the Treasury argued for a Select Committee to report on the proposal. Crucially, at a meeting with the Treasury in 1976, the Chancellor – Dennis Healey - decided on a Select Committee. The result was delay, and to give voice to Conservative members of the Committee to oppose the entire principle. Why was this decision taken?

- Concern of Treasury for confidence and capital flight: saw that 'This Green Paper is political dynamite', that 'will make a crucial impact on confidence – it will be almost a touchstone of or attitude towards enterprise and wealth'.
- Healey under pressure from the TUC to maintain the social contract and a wealth tax was part of the bargain – but he also feared alienating business which he was trying to reassure, and needed to create market confidence in the crisis of 1976. In 1976, he decided not to proceed to a White Paper. As a Treasury note explained: 'Our economic and financial management is now under more critical international scrutiny. There is a risk that the issue of a White Paper foreshadowing a WT will look irrelevant and unnecessarily provocative'. [11]

Opinion poll data show that support for a wealth tax declined. A survey of voters in two constituencies in the late 1970s found only 37 per cent of those who voted Labour thought a wealth tax was a good idea: it was more an issue for the activists than voters, and did not have the same level of popular engagement as the capital levy after the First World War.[12] Problems:

[11] Glennerster; Whiting 238-241.
[12] Whiting 238.

- Economists in the party realised a wealth tax would not produce the revenue Labour needed – the emphasis was on redistribution of wealth and economic power.
- Did not make the case for efficiency and enterprise that might have built more support: rather, the proposal was seen as a threat to property and savings in general – not everyone was clear on the threshold and that not liable. Would inflation bring them within scope?
- Issue of liquidity: farmers complained to Select Committee that have to sell land to pay, price risen but did not have cash. Emotional appeal of owners of English country houses: attracted a million signatures.

The 1979 manifesto did renew the plea for a wealth tax: 'In the next Parliament, we shall introduce an annual wealth tax on the small minority of rich people whose total net personal wealth exceeds £150,000.' It was not to be.

The idea of a wealth tax also appeared in James Meade's report on the reform of direct taxation of 1978. It built on Kaldor's argument for an expenditure tax, and on the arguments at the end of the war and by the Conservatives in the 1960s: how to remove the disincentive of higher income tax and to tax capital assets in a way that would encourage savings and modest fortunes. As well as a tax on expenditure [all sorts of income net of savings], he proposed a progressive annual wealth accessions tax on gifts and bequests. It would favour active over passive or inherited wealth. Meade assured Gefforey Howe that the result would e 'an upsurge of private initiative and enterprise'. Martin chick has considered the response of the Treasury, Inland Revenue and Howe to Meade. Let me just say that to Howe, it seemed too committed to equality tinged with socialism. He and Lawson embarked on other tax reforms to encourage enterprise. On the other hand, to Labour it was tinged with support for free enterprise.[13]

Will a wealth tax have any more success now? I agree that action is needed: there is growing inequality since the debates of the 1970s, with assets rising in value with tax-breaks; the returns to capital and capital have diverged since the squeeze on profits of the 1970s; capital is taxed more favourably than earned income.

[13] Chick, 'Reforming the structure of direct taxation'.

- The one-off wealth tax proposed by the Wealth Commission does little to redress these issues – its aim is to produce revenue for exceptional purposes.
- We need a longer-term solution that should have a number of strnds rather than the panacea of a annual wealth tax:
- Equalise tax of capital gains and income – and extend to main residence (as in US) – more likely than Martin Chick's idea of restoring schedule A income tax of imputed rent.
- Angus Deaton and Anne Case: not tax but prevent unearned increment from arising in the first place 'the right way to stop thieves is to stop them stealing, not to raise their taxes'.
- Return to land taxes as advocated by Martin Wolf.
- Deal with base erosion and profit shifting.
- Inheritance or accessions tax – need to deal with opposition which is leading to attempts to abolish so-called 'death taxes' in the United States. Could be linked to reform of social care.
- Above all - even before we thinking about details of taxation - need to produce a convincing narrative of why revenue is needed, who collective spending is efficient and socially desirable. The great LSE economic historian RH Tawney did that in his generation. Can we?

Reading

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